

OVERVIEW OF LOUISIANA'S  
UNFUNDED ACCRUED LIABILITY



INFORMATIONAL REPORT  
ISSUED MAY 20, 2011

**LEGISLATIVE AUDITOR  
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LOUISIANA LEGISLATIVE AUDITOR  
DARYL G. PURPERA, CPA, CFE

May 20, 2011

The Honorable Joel T. Chaisson, II,  
President of the Senate  
The Honorable Jim Tucker,  
Speaker of the House of Representatives

Dear Senator Chaisson and Representative Tucker:

This report provides a summary and analysis of the unfunded accrued liability for the four state retirement systems, including the Louisiana State Employees Retirement System (LASERS), the Teachers Retirement System of Louisiana (TRSL), the Louisiana State Police Retirement System (STPOL), and the Louisiana School Employees Retirement System (LSERS).

I hope this report will benefit you in your legislative decision-making process.

Sincerely,

A handwritten signature in blue ink that reads "Daryl G. Purpera". The signature is written in a cursive style.

Daryl G. Purpera, CPA, CFE  
Legislative Auditor

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## Executive Summary

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In response to legislative interest, we have answered the questions in this report regarding the state and employees' retirement system costs.

### **What are the current employer and employee contribution rates for the four state retirement systems?**

**Results:** For the current employer and employee contribution rates, see Exhibit 2 on page 3.

### **How are the current contribution rates allocated between initial unfunded accrued liability (IUAL), new unfunded accrued liability (UAL), and normal cost?**

**Results:** For a graph showing how current contributions are allocated for all four state retirement systems, see Exhibit 3 on page 4. Of the current total contribution rates, the majority is allocated to pay for the IUAL and new UAL payments. Of the employer contribution only, 67% to 75% is allocated to pay for IUAL and new UAL balances, which are costs attributable to benefits already promised. In addition, employees in LASERS and TRSL currently pay over 52% of the normal costs.

### **How have employee and employer contribution rates changed since 1987?**

**Results:** Employee contributions for LASERS and TRSL have remained at an average of about 8% of pay since 1987. Employer contributions have increased greatly over the 24-year period. For example, LASERS employer contributions have ranged from a low of 7% in fiscal year 1990 to a high of over 25% in fiscal year 2012.

### **Why have employer contribution rates increased over the past decade?**

**Results:** Employer contribution rates have increased for these key reasons:

- Delayed amortization leading to principal growth
- Investment losses
- Allocations of investment gains to pay cost-of-living adjustments
- Net actuarial losses
- Additional benefits promised

### **Will contribution rates continue to increase?**

**Results:** Contribution rates will continue to increase because of the existing IUAL payment schedule and the likelihood of investment losses in the next two years.

**Background**

**History of the Unfunded Accrued Liability (UAL).** In 1987, the legislature amended the constitution to require that all state retirement systems<sup>1</sup> be funded on an actuarially sound basis. This requires, in part, that the UAL<sup>2</sup> be eliminated.<sup>3</sup> At that time, the UAL totaled approximately \$5.8 billion. To meet this constitutional mandate, the legislature established a 40-year amortization schedule with increasing annual payments beginning July 1, 1988. This UAL is referred to as the initial UAL or IUAL. Two of Louisiana’s four state retirement systems, LASERS and TRSL, still have an IUAL balance.

The Louisiana Constitution requires that the IUAL be completely paid off by June 30, 2029.<sup>4</sup> Thereafter, the only cost to employers for retirement benefits would be employer normal costs, or the costs of benefits earned each year, and payments to amortize offsetting investment and actuarial gains and losses. The state’s costs for retirement systems would no longer include payments for the IUAL. Since 1987, however, factors such as actuarial and investment losses have created additional UAL (referred to as new UAL in this report). As of June 30, 2010, the total UAL balance of all four state retirement systems was \$18.2 billion.

**Components of Retirement Costs.** Employee and employer contributions, along with investment returns, fund the benefits promised by each retirement system. The total contribution rate represents a percentage of the total salaries of employees in each retirement system. Because new UAL has been created since 1987 for each of Louisiana’s four state retirement systems, employee and employer contributions must pay for these costs. Exhibit 1 shows the components of each system’s cost in terms of IUAL, new UAL, and normal costs.

<b>Exhibit 1</b>			
<b>Components of State Retirement Systems’ Costs</b>			
	<b>IUAL Cost</b>	<b>New UAL Cost</b>	<b>Normal Cost</b>
<b>LASERS</b>	√	√	√
<b>TRSL</b>	√	√	√
<b>STPOL</b>	Paid off	√	√
<b>LSERS</b>	Paid off	√	√
<b>Source:</b> Created by legislative auditor’s staff using information in the retirement systems’ valuation reports.			

<sup>1</sup> Includes LASERS, TRSL, STPOL, and LSERS.

<sup>2</sup> The UAL is the total amount of benefit obligations minus the current actuarial value of assets – any promised liability that cannot be covered by current assets.

<sup>3</sup> R.S. 11:271.

<sup>4</sup> LA-Const. Art. 10, §29(E)(2)(c).

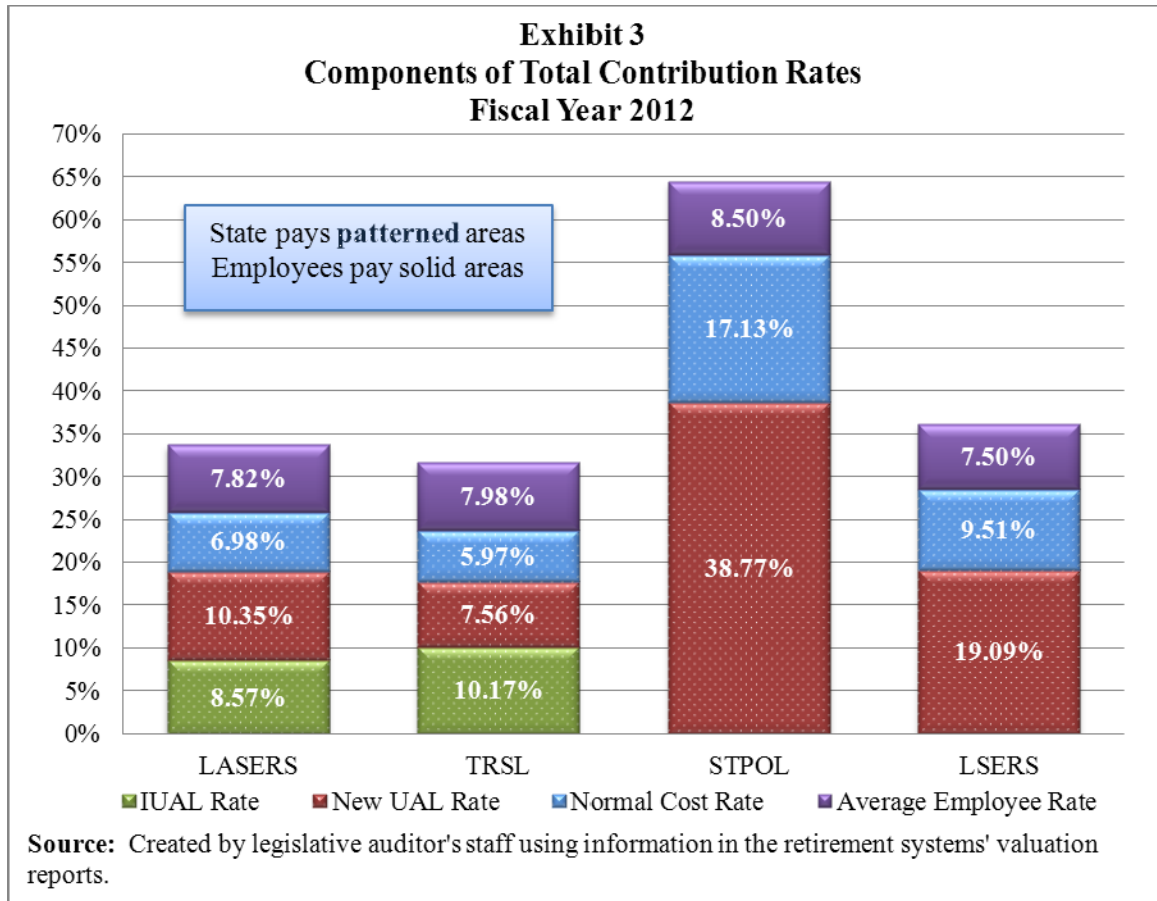
**What are the current employer and employee contribution rates for the four state retirement systems?**

The employee and employer contributions of the four state retirement systems for fiscal year 2012 are shown in Exhibit 2.

<b>Exhibit 2 Retirement System Contribution Rates Fiscal Year 2012</b>				
	<b>Total Employer Rate</b>	<b>Average Employee Rate*</b>	<b>Employee Rate Range**</b>	<b>Total Rate</b>
<b>LASERS</b>	25.90%	7.82%	7.0%-11.0%	33.72%
<b>TRSL</b>	23.70%	7.98%	5.0%-9.1%	31.68%
<b>STPOL</b>	55.90%	8.50%	8.5%-9.5%	64.40%
<b>LSERS</b>	28.60%	7.50%	7.5%-8.5%	36.10%
<small>*Represents a weighted-average rate based on the FY 2012 rate of each sub-plan and the number of members in each sub-plan. For STPOL and LSERS, this rate is the actual rate that applies to all members that joined the system before January 1, 2011. No information is available yet relative to members joining STPOL or LSERS on or after January 1, 2011.  ** LASERS has 19 sub-plans; TRSL has 4 sub-plans; STPOL has 2 sub-plans; and LSERS has 2 sub-plans with varying employee contribution rates.  <b>Source:</b> Created by legislative auditor’s staff using information in the retirement systems’ valuation reports.</small>				

**How are the current contribution rates allocated between IUAL, new UAL, and normal cost?**

**Total Contribution Rates.** Exhibit 3 shows the components of the total contribution rates for FY 2012 for all four state retirement systems. According to state statute, state employees pay a fixed contribution rate toward the normal cost, as shown in purple in Exhibit 3. The state, through employers, pays for the IUAL, UAL, and the remainder of the normal cost, which is shown in the green, red, and blue patterned areas in Exhibit 3. For each of the four state retirement systems, UAL payments represent more than 50% of the total of all contributions (employer and employee).



**Employer Contribution Rates.** Exhibit 3 shows the employer contribution components for all four state retirement systems. As discussed previously, the UAL payment is over 50% of the total (employer and employee) contribution. In addition, 67% to 75% of the total employer contribution is allocated toward paying off the UAL balances. Normal costs, or the costs incurred for benefits promised each year, represent only 25% to 33% of the total employer contribution. Therefore, the majority of the current employer contribution is attributable to benefits already promised rather than current year and future benefit promises.

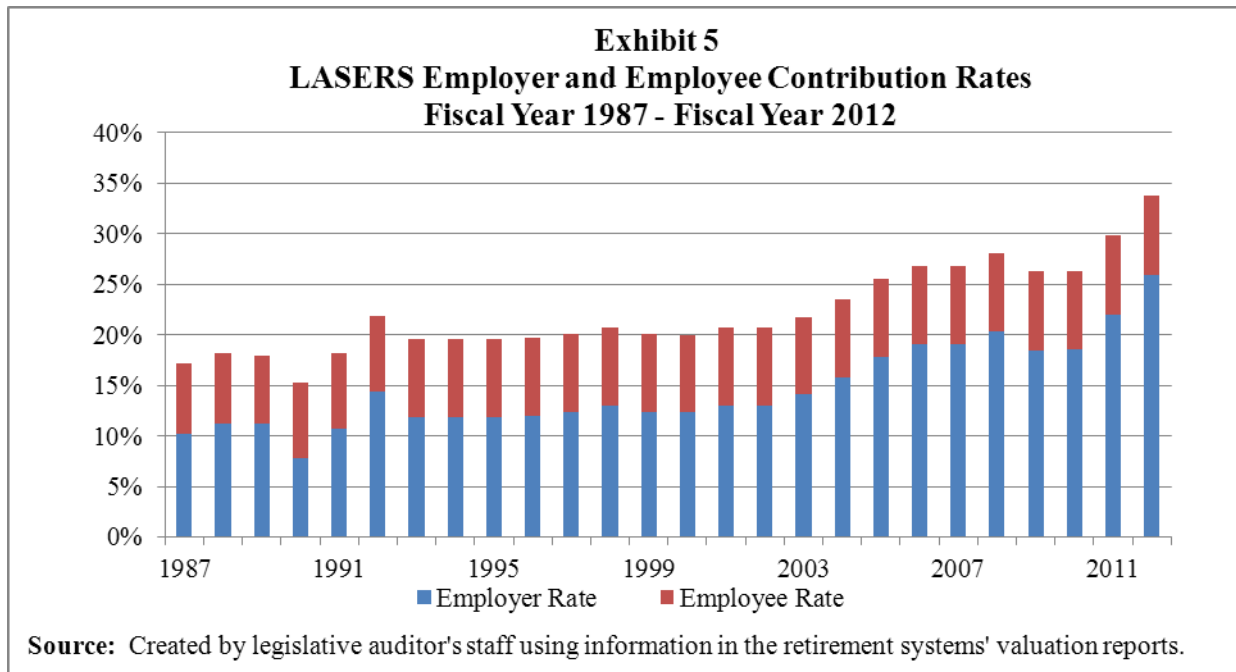
**Employee Contribution Rates.** Exhibit 4 compares the amounts employees pay as a percentage of the total normal cost for each of the four systems as well as the amounts paid toward other components of the total retirement contributions. For fiscal year 2012, employees in the four state systems pay between 33% and 57% of the total normal costs. For TRSL and LASERS, the employee contributions represent over 52% of the normal cost. When compared to the new UAL and total normal cost rates, employees in the four systems paid between 13% and 37% of these costs. Finally, employee contributions represent between 13% and 25% of all components (IUAL, new UAL, and normal costs) of the contribution rate.

<b>Exhibit 4</b>			
<b>Amount Employees Pay as a Percent of:</b>			
<b>Fiscal Year 2012</b>			
	<b>Total Normal Cost Rate Only</b>	<b>New UAL + Normal Cost Rate</b>	<b>Total Rate (All 3 Components)</b>
<b>LASERS</b>	52.84%	31.09%	23.19%
<b>TRSL</b>	57.20%	37.10%	25.19%
<b>STPOL</b>	33.16%	13.20%	13.20%
<b>LSERS</b>	44.09%	20.78%	20.78%

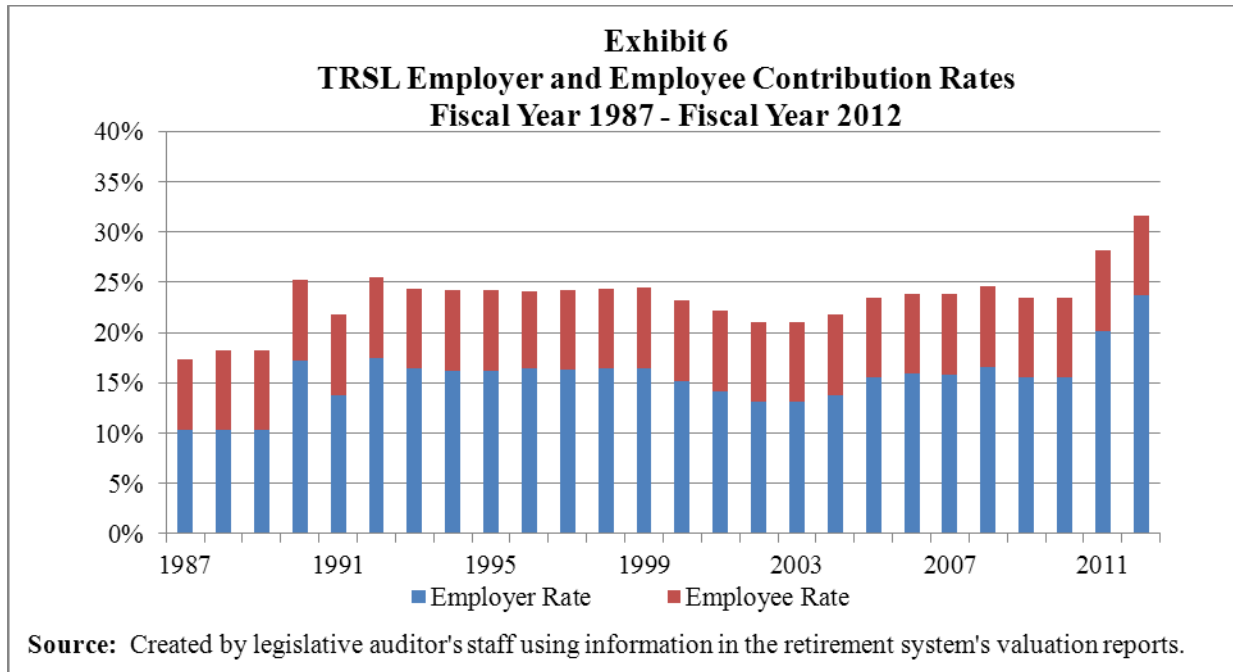
**Source:** Created by legislative auditor's staff using information in the retirement systems' valuation reports.

**How have employee and employer contribution rates changed since 1987?**

**Total contribution rates for LASERS and TRSL have increased over the past 24 years.** Employee contribution rates have remained at an average of about 8% of pay for the past 24 years. LASERS employer rates have increased in general and have ranged from a low of around 7% in fiscal year 1990 to a high of over 25% in fiscal year 2012. Exhibit 5 shows how the contribution rates for LASERS have changed since 1987. The general trend has been the same for TRSL, as shown in Exhibit 6 on the following page.







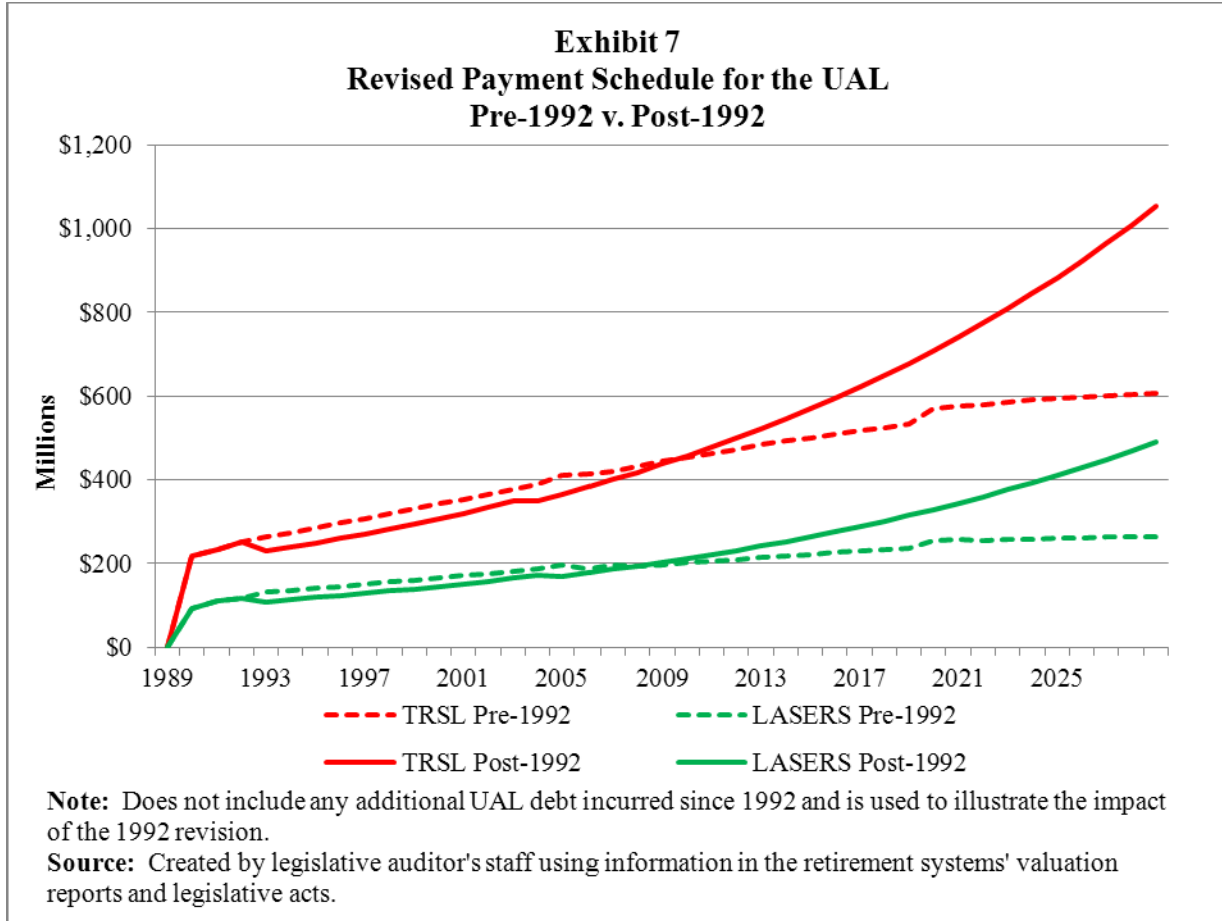
**Why have employer contribution rates increased over the past decade?**

Employer contribution rates have increased over the past decade for the five main reasons discussed below.

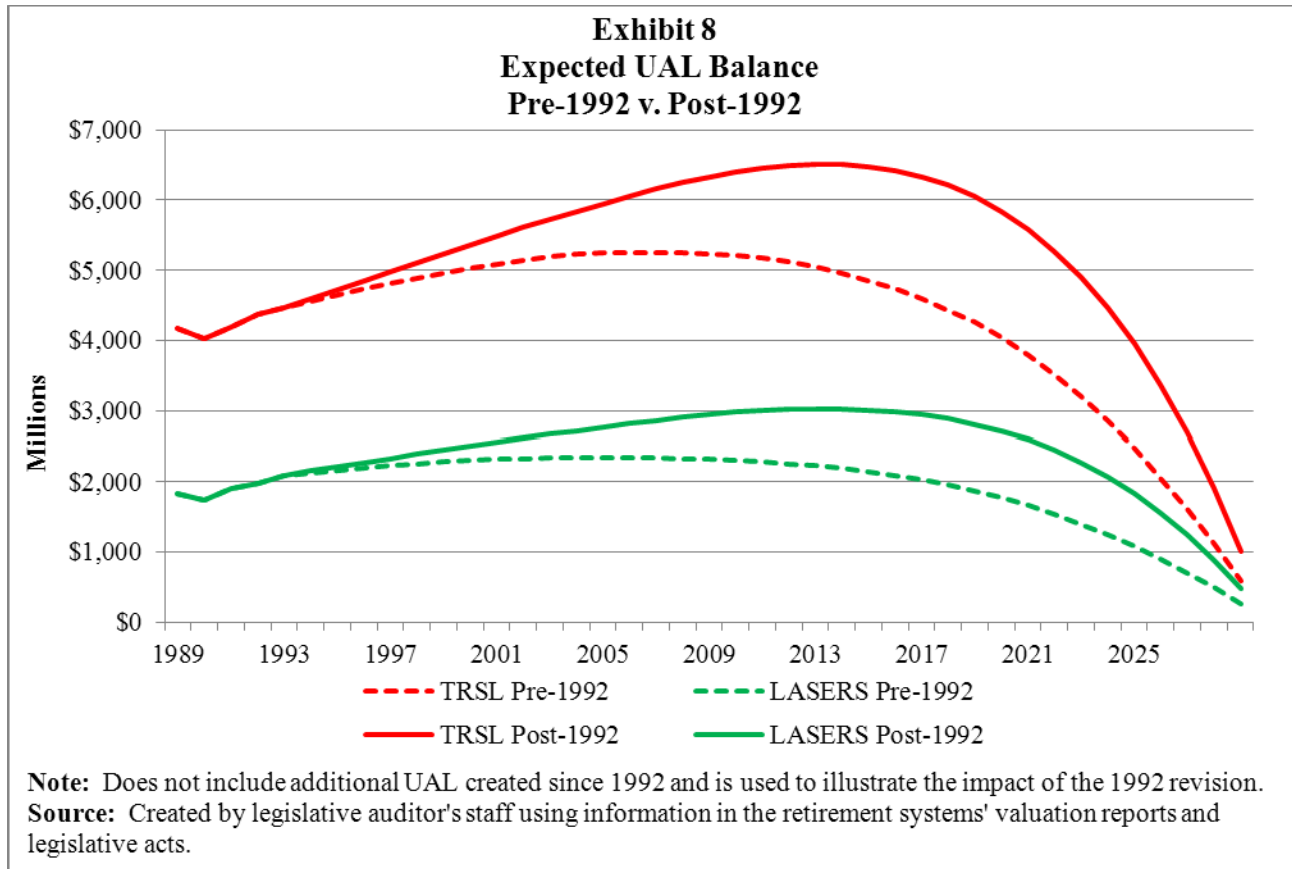
**Delayed Amortization Leading to Principal Growth**

The state chose an amortization method for the initial debt (IUAL) that called for payments during the first 15 years or so of the 40-year schedule to be less than the interest charged on the outstanding balance. As a result, payment on the debt was not only postponed but also the debt was allowed to grow as well. The intent of the amortization method was to have payments that would be relatively constant as a percentage of payroll under the assumption that payments would increase in the same manner as the total payroll. The downside to this arrangement was to have payments for the first 15 years or so that would not be sufficient to pay interest and the debt would increase each year until about 2005. Thereafter, the outstanding debt would begin to decline, but it would not return to its original level until about 2020.

In 1992, the state modified the payment schedules to reduce payment amounts and to increase the debt even more. These changes, illustrated in Exhibit 7, modestly reduced contribution requirements through 2009, only to cause it to be significantly larger in later years.

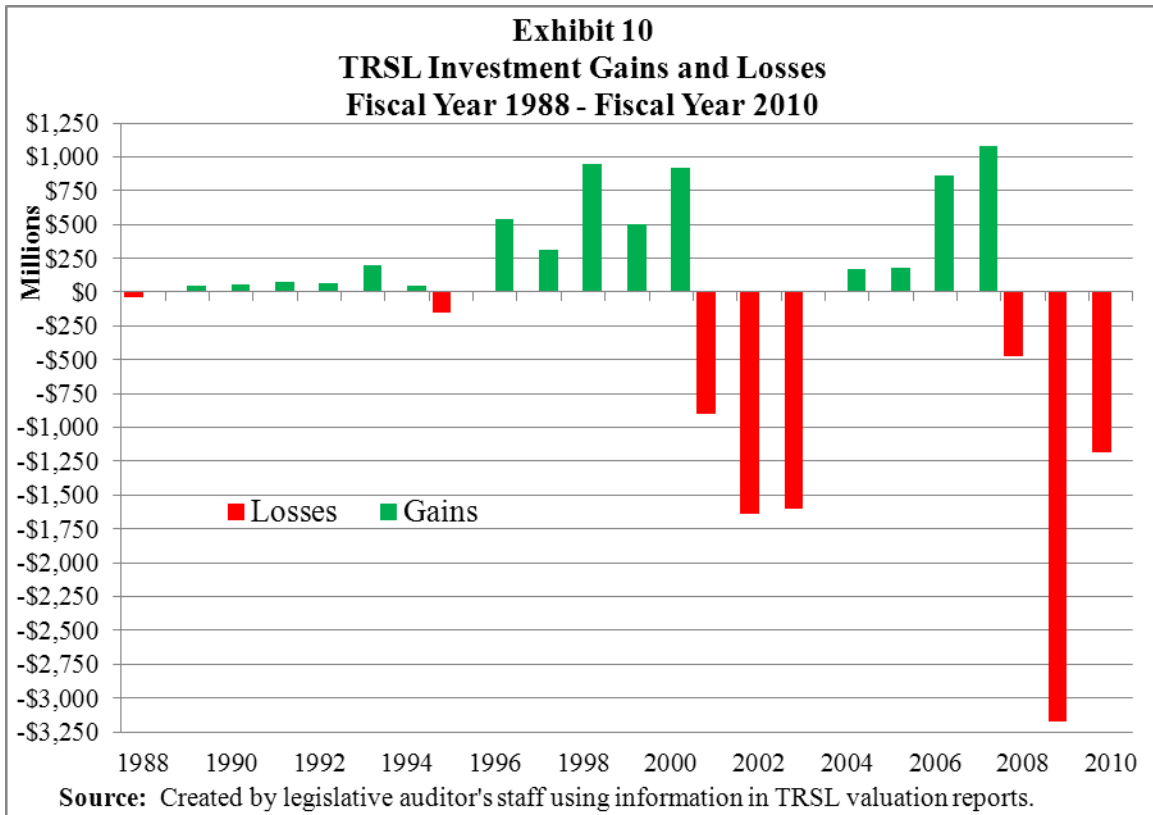
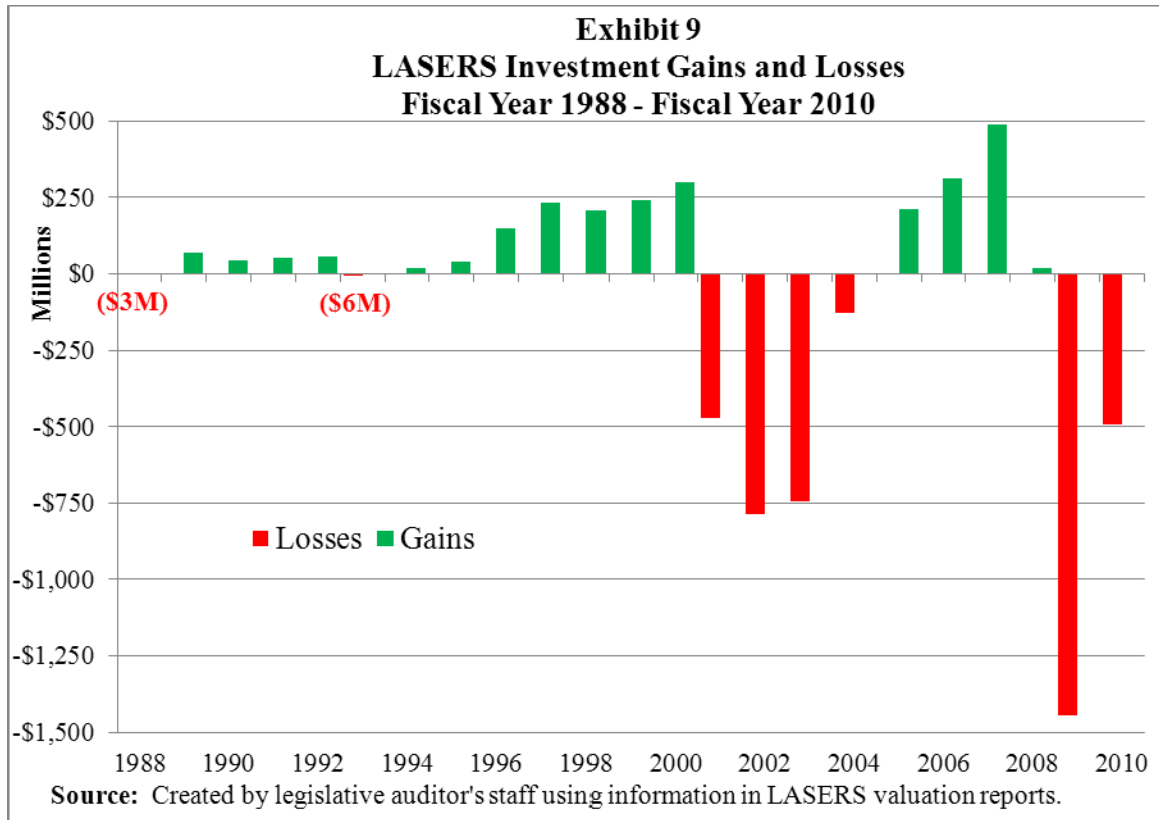


As a result of the new payment schedule, growth of the debt was extended for another 10 years from 2005 to 2015. Furthermore, the date that the debt would return to its original level was postponed from 2020 to 2024. As a result, payment toward the original debt was postponed for 24 years with the entire debt being paid off over a five-year period from 2024 to 2029. Although significant revisions were made in the amortization schedule in 2004 and 2009, the pattern of increases essentially remained the same.



## Investment Losses

**The state debt increased because of net investment losses. Most of these losses have occurred in the last three years.** When a retirement system earns more or less than its assumed investment rate of return, an investment gain or loss occurs. Retirement systems assume that investment losses and gains will even out over time. For LASERS and TRSL, gains as measured before the allocations for cost-of-living adjustments discussed on page 10, were sufficient to offset any losses through 2007. However, since no investment gains have occurred since 2007, there is a net investment loss, which adds to the UAL balance.



## Allocations of Investment Gains to Pay Cost-of-Living Adjustments

The state used investment gains to provide cost-of-living adjustments (COLAs). These gains were unavailable to offset investment losses occurring from 2001-2003 and 2008-2011. All four state retirement systems use a formula to provide for COLAs.<sup>5</sup> In years with investment gains, half of the gains were credited to an experience account to pay COLAs. As a result, the full amount of investment gains was not available to fully offset investment losses in 2001-2003 and 2008-2011.

## Net Actuarial Losses

The state debt increased because of net actuarial losses. In actuarial valuations, certain demographic assumptions are chosen that predict turnover, salaries, and the number of retirees, disabilities, and deaths. If the actuarial assumptions are reasonable over the long term, gains and losses should cancel each other out. However, since 1995, losses have exceeded gains and increased the UAL.

## Additional Benefits Promised

The state debt increased because of additional benefits promised. Benefit provisions for LASERS and TRSL have not changed significantly since 1988. However, benefit accrual rates for LSERS were substantially increased in 1993 and 2001 and benefit accrual rates for STPOL were increased in 2001.

Exhibit 11 shows how much the components discussed above contributed to the new UAL for the four state retirement systems.

<b>Exhibit 11</b>	
<b>Components of State Retirement Systems' UAL</b>	
<b>As of Fiscal Year 2010</b>	
<b>Component</b>	<b>Amount</b>
Initial UAL (1989)	<b>\$5,844,000,000</b>
Additions to UAL, including:	<b>12,391,000,000</b>
Delayed Amortization Leading to Principal Growth	3,272,000,000
Investment Losses	5,370,000,000
Allocations of Investment Gains to Pay COLAs	2,432,000,000
Additional Benefits Promised	148,000,000
Net Actuarial Losses	1,169,000,000
<b>Total at FYE 2010</b>	<b>\$18,235,000,000</b>
<b>Source:</b> Created by legislative auditor's staff using information in the retirement systems' valuation reports.	

<sup>5</sup> LASERS and TRSL have used a COLA formula since 1992. STPOL and LSERS have used one since 2007. However, LSERS and STPOL have not had any investment gains since the statute was added and thus have not used the formula to credit investment gains to the experience account.

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**Will contribution rates continue to increase?**

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Based on these factors that have caused total retirement contributions to increase to their current values, contribution rates will continue to increase for the following reasons:

- The schedule of payments to pay off the state's retirement systems' debt for the IUAL provided for gradual increases in the first half of the 40-year payment schedule and sharply increasing payments in the second half. The retirement systems are now approaching the steep portion of the slope of scheduled payments.
- According to legislative auditor's actuarial staff, the retirement systems are likely to experience more investment losses on the actuarial value of assets over the next two years. The amount of the increase in contribution rates depends on investment losses and any changes that the state may make to the UAL amortization schedule.

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